Should you have a global strategy?

When Should Companies Go Global?

Since different industries are structured differently, knowing the level of, and changes in industry concentration can help managers determine what global strategy to adopt to become more competitive.

by Chris Carr and David Collis

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Senior executives weighing strategies appropriate for today's global economy will hear contradictory advice. Some say you need to move quickly to establish a worldwide presence before competitors; others cite data showing that this is often less profitable. Those making the case for taking a global approach, including Thomas Friedman in *The World Is Flat*, argue that success requires treating the world as a single entity. Those advocating a more geographically restricted, regional strategy say that the world is, at best, semi-integrated, and that smart companies can capitalize on regional and country differences. The reality is that neither approach is appropriate for every circumstance. Therefore, executives need to understand when to pursue one route and when to pursue the other.

In our view, the criteria need to be tied the dynamics of the particular industry, specifically the concentration levels of the four largest competitors (what we call the global CR4 ratio). Our analysis of 50 industries reveals extremely high global concentration ratios averaging 50% - just 1.5% higher than eight years ago. This small increase does not by itself say that industry is becoming more global. In fact, it conceals dramatic differences from industry to industry: some, such as steel and cement, have seen huge increases in concentration; others, such as autos, have actually seen a decline in global concentration. To appreciate the strategic impact of these changes, one must recognize that these two variables (global CR4s and changes in these global CR4s) frame four competitive scenarios (see “Sectoral Global Concentration Trends”). Each scenario has a different opportunity for profit and a different set of implications for how companies can compete. Knowing your industry’s global CR4, and whether this is increasing or decreasing, can help you decide what you should or shouldn’t do strategically.

A Case for Globalization

Traditionally, economists such as Scherer and Ross found that by the time that the four largest players in a domestic industry achieved a combined market share approaching 40%, they would fully recognize their mutual interdependence. By this point, attempts to gain market share by one company were expected to spur responses from rivals, encouraging oligopolistic collusion. By the time global CR4’s reach the same 40% point, we think leading players need to acknowledge their mutual interdependence and adopt a global strategy. Even where the level of concentration is lower, we think that managers can still make a compelling case for globalization where CR4s are increasing and beginning to approach this critical 40% threshold.

When airplanes first broke the sound barrier, test pilots had difficulty controlling their aircraft (indeed, several crashed) until engineers realized that control principles, as we approach and surpass the sound barrier, are different from those below it. We see an analogous phenomenon occurring with regard to companies' understanding of industry concentration. Falling global concentration is traditionally treated by economists as a sign of international fragmentation and of competition not being truly global. However, once this critical threshold of 40% is approached, falling CR4s can also mean that global incumbents are being challenged by new competitors, and that global wars are finally breaking out in earnest.

In the context of the global economy, concentration levels tend to decrease when countries that were previously outside the established international marketplace become major markets themselves. Indigenous companies from emerging markets often succeed at developing strong positions within those markets and then use those positions to gain global market share. For example, Haier Group, the Chinese consumer electronics and home appliance maker, parlayed its domestic cost advantages and business model developed to meet market needs in China into a growing market share elsewhere. Such gains don't portend the demise of globalization; rather, they suggest that incumbents need to develop global strategies to confront threats from emerging global competitors.

The world automobile industry offers a useful example. This market has seen slightly reduced concentration in the past two decades. However, if anything, the current level of competition in Asia and the extent to which competitors such as South Korea's Kia and Hyundai have made market inroads in Europe and North America point to an increasingly dynamic industry. What had been a cozy global oligopoly that provided a protective umbrella to weaker international players such as Chrysler has given way to all-out global war. Under this scenario where the global CR4 has already reached the critical 40% level, falling industry concentration is actually a harbinger of increasing global rationalization and rivalry, and it spells big trouble for all but the most committed international players.

Reading the Data

Global concentration levels and changes in these levels can help point companies to the most effective strategies (see "Sectoral Global Concentration Trends"). Based on our analysis of industry data, we have identified four contexts and likely evolutionary paths:

- Global oligopolies. Industries with global concentration ratios above 40% and increasing concentration levels are "global oligopolies." In such industry environments (example: mobile phones), oligopoly power is both high and increasing as incumbents attempt to leverage their scale advantages.
- Global wars. Industries where the concentration is above 40% but where the concentration level is decreasing have a different dynamic, one we call "global wars." In these settings, incumbent global champions are ceding market share to aggressive new rivals.
- Regional and national terrains. Industries where concentration levels are below 40% and where concentration is low or declining (as is common in the service sector) tend to be organized either regionally or nationally as opposed to globally.
- Shifting terrains. Industries where changes are in train and where concentration, while modest, may be growing rapidly (for example, steel) can be described as

shifting terrains. In these sectors, companies should pay careful attention to the shift from local to global strategy.

Since the nature of competition differs from industry to industry, the strategy recommendations vary. However, managers should be wary of dismissing scenarios other than their own as irrelevant. As we will show, patterns of evolution are dynamic; terrains often undergo significant changes as globalization proceeds.

Global oligopolies. The global oligopolies terrain is a relatively forgiving environment for companies at this stage of industry evolution. Indeed, given the generous profit margins, it could even prove hospitable to weaker international players. There are three main ways to become a participant in this industry structure, each of which requires international integration.

The first way to become a major player is through innovation in developing new industry sectors. For example, in digital technologies, Microsoft, Google and Facebook, respectively, quickly established dominant positions. All scooped huge global industry profit shares through winner-takes-all effects, though outright monopolies are unacceptable to regulations, and innovation advantages alone are rarely sustainable.

The second way is to leverage scale and specialization, as can be seen in capital-intensive businesses such as aerospace, glass, domestic appliances, and tires. This strategy is typically deployed by incumbents. "Domestic appliance" global leaders Whirlpool and Electrolux, for example, leveraged domestic scale before expanding their geographic footprint to further economies of scale; and, again even more recently, Haier, the new global number four, succeeding in leveraging a focus on smaller and lower price products, together with labor cost advantages and the scale afforded by China's huge, fast-growing market.

The third approach is through ambitious global consolidation strategies using mergers and acquisitions. The beer industry provides a good example. Until the 1990s, beer was largely a domestic business; national players such as Bass in the United Kingdom and Anheuser-Busch in the United States were extremely profitable. Then a few players, such as S&N in Europe and SAB in Africa, began build regional market positions through acquisitions. Within a few years, global consolidation reshaped the industry, with SAB taking over Miller, and Heineken and Carlsberg dividing up S&N. Brazil's AmBev merged with Belgium's Interbrew and finally Anheuser-Busch. Over the past decade, every substantial national player in Britain, France and the United States has disappeared.

Overall the first approach still tends to be the preserve of highly innovative players from advanced "Triad" regions; but notice how new emerging country champions are increasingly following suit on these second and third approaches to exploit any complacency by traditionally powerful incumbents.

Global wars. Even while global concentration falls within an industry, the total number of industry incumbents often declines in this scenario. In competitive global businesses, there have to losers; while the market leaders might only lose share, companies that managed to survive as national or regional champions find it increasingly difficult to hold on largely because of overcapacity. Such industry reshaping occurred recently in the auto industry. Indeed, the total number of auto manufacturers has declined steadily since World War II even as the new competitors from Japan, Korea, China, and India gained share.

Regional competitors in this scenario can improve their ability to compete through international alliances and acquisitions, but to be a credible player they must commit themselves to genuine cross-border integration. Ultimately, they need to be prepared to join forces with a global leader. Chrysler will almost certainly fare better in the global partnership with Fiat than it ever could have done under Cerberus' ownership. Loss of sovereignty is a tough decision for any management team, but life does not end after integration.

For new contenders in such globally competitive markets, learning to leverage innovative domestic business models through organic growth can be the most successful globalization path. Toyota and Honda provide good examples. Indeed, given the challenges of post-merger integration across continents, the last thing newcomers should attempt to do is imitate traditional players. In China, the struggles of both Lenovo (in computers) and TCL (in electronics) reflect this reality.

Regional and national terrains. The reality is that global consolidation is still not appropriate in many parts of the economy. Other sectors in this category would include house-building, railways, and service businesses, such as hairdressers and dental services. These are sectors where the underlying economics support small, localized competitors due to low scale economies, greater logistical costs, differences in cultures and consumer tastes, or more importantly continuing regulatory or governmental barriers. It is highly unlikely that any single player would have the ability alter this terrain. In these markets, attempts to pursue global strategies are risky; indeed, they could destroy shareholder value.

Shifting terrains. In some sectors, global concentration may not have yet occurred but change may be underway. Even in sectors that economists have considered national or regional, including steel, confectionery, airlines, spirits, cosmetics, and cement, we see increased jockeying for global market position, as the top four players close in on 40% concentration levels.

Companies in sectors experiencing change should anticipate the effects of global concentration. Players with deep pockets have opportunities to make early moves to expand their market positions and sustain profits for many years. Some strategies rely almost exclusively on internal growth: for example, Spanish fashion retailer Inditex (Zara) has expanded from Europe to stores in 78 countries to become the world's largest, most valuable listed fashion retailer. However, the need for rapid increases in scale may argue for growth through acquisitions.

The cement market offers an interesting case study. Long a fragmented and regional industry, it has recently become a battleground for global concentration, with Mexico's CEMEX going head to head with France's Lafarge and Switzerland's Holcim for international market leadership. A similar dynamic is being played out in steel, where the geography of competition and strategy has been dramatically transformed in just the last decade by Mittal Steel from India. Nevertheless, companies pursuing global strategies need to be attentive to the needs of local customers and the business culture, and recognize that having standardized practices across the whole enterprise might not be the right approach. Wal-mart, for example, spent nearly a decade trying to establish itself in Germany before finally selling its German operation in 2006.

Anticipating Turning Points

Examples of companies that held firm to their local or regional strategies in the face of indications that their industry was becoming more concentrated and suffered accordingly are fairly common. In the traditional mobile phone market , for example, the global CR4 increased from 49% in 1988 to 73% in 2008. Nokia successfully leveraged its innovation-based strategy to build a global market share of 40%, with even stronger market positions in India (57%), Asia (46%), and Africa (66%). Motorola, by contrast, struggled, having largely restricted itself to the United States and South America, where it and Nokia each held 26% of the market. Globally, Motorola's share declined to around 10%. Even Nokia must now raise its global game to a new level, because the new smart phone market segment is already experiencing a turning point. In early 2011, Nokia's global share is just 29%, compared with Samsung at 18%, not to mention challenges from new disruptor technologies from Blackberry, Apple and Google. This could mark the transition to our global war scenario.

Since different industries are facing different circumstances, managers need to keep tabs on current conditions and what is likely to unfold. For example, it's important to recognize the difference between a steady state "global oligopoly" and a "global war," where global CR4 concentration levels fall as leading incumbents later cede ground to new overseas challengers, battling for supremacy. It's also important to monitor how many significant players there are in your sector. If incumbent numbers are falling, you are probably entering into a highly competitive scenario. Misinterpreting these turning points can be dangerous.

Finally, it's important to keep in mind that Rome wasn't built in a day and that full geographical integration doesn't occur overnight. First, as successful companies such as Honda, Diageo and HSBC have shown, you need develop a roadmap for international expansion. We have provided an overview of the global concentration landscape and some initial measures, but beware. In the more sharply defined business segments where most companies compete, global concentration may already be a lot higher than in their sectors more broadly defined. The global CR4 for stainless steel is today 36%, twice that for steel taken overall. The need for a global strategy may prove even more acute on closer examination.

SECTORAL GLOBAL CONCENTRATION TRENDS: RECENT CR4s VS. ON AVERAGE 8 YEARS AGO